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SERVICE DATE - FEBRUARY 20, 1998
SURFACE TRANSPORTATION BOARD¹

DECISION

No. 40073

SOUTHWEST RAILROAD CAR PARTS COMPANY
v.
MISSOURI PACIFIC RAILROAD COMPANY

Decided: February 11, 1998

In a decision in this proceeding served December 31, 1996 (*'96 Decision*), we tentatively found that the challenged rail rate previously charged by defendant Missouri Pacific Railroad Company (MP)--now part of the Union Pacific Railroad Company (UP)²--for transporting retired rail cars was not unreasonable. The complainant, Southwest Railroad Car Parts Company (SWRC), seeks further consideration, and UP has replied. These submissions indicate that, contrary to the ICC's earlier finding, an indispensable jurisdictional prerequisite to our authority to review the reasonableness of the challenged rate is lacking in this case. Accordingly, we direct SWRC to show cause why this proceeding should not be dismissed for lack of market dominance.

BACKGROUND

Market Dominance Limitation

We may consider the reasonableness of a challenged rail rate only if the carrier has "market dominance" over the traffic at issue.³ "Underlying this [statutory restriction on our regulatory authority] is the theory that if the railroad does not have market dominance competitive pressures

¹ This proceeding was pending with the Interstate Commerce Commission (ICC) prior to January 1, 1996. Therefore, under section 204(b)(1) of the ICC Termination Act of 1995, Pub. L. No. 104-88, 109 Stat. 803 (1995) (ICCTA), this decision applies the law in effect prior to the ICCTA and citations refer to the law in effect on December 31, 1995, unless otherwise indicated.

² At the time of our *'96 Decision*, MP was a separate subsidiary of the Union Pacific Corporation, which also owned UP. MP has since been merged into UP, pursuant to *Union Pac. R.R.--Corporate Family Exemption--Missouri Pac. R.R.*, STB Finance Docket No. 33320 (STB served Jan. 15, 1997).

³ 49 U.S.C. 10701a(b)(1), 10709. Market dominance is "an absence of effective competition from other carriers or modes of transportation for the transportation to which a rate applies." 49 U.S.C. 10709(a). A finding of market dominance does not in itself suggest that the rate is unreasonable, however. 49 U.S.C. 10709(c).

will keep rail rates at a reasonable level.”⁴ But even if the railroad chooses not to reduce a rate that a shipper asserts is too high, the shipper can avoid paying such a rate if it has other competitive options.⁵ Thus, where the shipper can exercise competitive alternatives, our regulatory rate intervention is unnecessary. The fact that it may take some time for a shipper to exercise its competitive alternatives does not preclude a finding of no market dominance. Short-term or transitory market power is insufficient to establish market dominance.⁶

A market dominance analysis contains both quantitative and qualitative components. Quantitatively, the statute precludes a finding of market dominance where a carrier shows that the revenue produced by the movement is less than 180% of its “variable cost” of providing the service.⁷ Congress has determined that a railroad does not exercise undue market power when it prices traffic below the 180% revenue-to-variable cost (r/vc) level. Pricing traffic above that level, however, does not create a presumption that the carrier has market dominance over the traffic.⁸ Rather, we must conduct a qualitative analysis to determine whether the carrier has market dominance over the traffic involved.

In the qualitative analysis, we examine the competitive alternatives available to the shipper, including intramodal, intermodal, geographic, and product competition.⁹ “Intramodal competition” refers to competition between two or more railroads transporting the same commodity between the same origin and destination.¹⁰ “Intermodal competition” refers to competition between rail carriers and other modes for the transportation of a particular product between the same origin and

⁴ *Arizona Public Serv. Co. v. United States*, 742 F.2d 644, 647 (D.C. Cir. 1984) (*Arizona*).

⁵ *Salt River Project Agric. Improvement & Power Dist. v. United States*, 762 F.2d 1053, 1064 (D.C. Cir. 1985) (*Salt River*).

⁶ *Salt River*, 762 F.2d at 1065.

⁷ 49 U.S.C. 10709(d)(2). Variable costs are determined using the Uniform Rail Costing System (URCS), developed by the ICC to replace the Rail Form A cost finding methodology. 49 U.S.C. 10709(d)(1)(3), 10705a(m)(1). The URCS costing formula is a means of reflecting the extent to which the different categories of costs incurred in the rail industry have been found to change in direct proportion to changes in output.

⁸ 49 U.S.C. 10709(d)(4).

⁹ *Product and Geographic Competition*, 2 I.C.C.2d 1, 4 (1985) (*MD Guidelines II*), modifying *Market Dominance Determinations*, 365 I.C.C. 118 (1981) (*MD Guidelines I*), *aff’d sub nom. Western Coal Traffic League v. United States*, 719 F.2d 772 (5th Cir. 1983) (*en banc*), *cert. denied*, 466 U.S. 953 (1984).

¹⁰ *MD Guidelines I*, 365 I.C.C. at 132.

destination.¹¹ “Geographic competition” exists where the shipper can conduct its business by obtaining the goods it needs from a different source and/or shipping its product to a different destination using another carrier.¹² “Product competition” exists when a receiver or originator can substitute other products moving over different lines for the product covered by the rail rate at issue.¹³

The complaining shipper makes an initial showing of market dominance by establishing that there are no direct transportation alternatives for the movements at issue (intramodal or intermodal competition) that provide effective competition.¹⁴ At that point, the evidentiary burden shifts to the defendant railroad to rebut this evidence or to show that indirect competitive alternatives (geographic and/or product competition) provide effective competition.¹⁵

We base our analysis on the specific market(s) involved, and not broad-brush generalities about competitive conditions in unspecified markets.¹⁶ We consider potential, as well as actual, competition in determining whether effective alternatives exist.¹⁷ The question is whether an alternative is feasible, not whether it has been used in the past.¹⁸

History of This Case

As explained more fully in the ‘96 *Decision*, SWRC filed a complaint with the ICC in December 1985, alleging that the flat rate of \$300 per car charged by MP for the movement of retired railroad cars from five points in Texas and Louisiana¹⁹ to SWRC's salvage yard in Greggton,

¹¹ *Id.* at 133.

¹² *MD Guidelines II*, 2 I.C.C.2d at 3, 22.

¹³ *Id.* at 9, 22.

¹⁴ *MD Guidelines II*, 2 I.C.C.2d at 14-15.

¹⁵ *Id.* See *Metropolitan Edison Co. v. Conrail et al.*, 5 I.C.C.2d 385, 412 n.34 (1989).

¹⁶ *Arizona*, 742 F.2d at 654-55.

¹⁷ *MD Guidelines II*, 2 I.C.C.2d at 10.

¹⁸ *MD Guidelines I*, 365 I.C.C. at 131; *Salt River*, 762 F.2d at 1059; *Aluminum Ass’n, Inc. et al. v. Akron, C.&Y.R.R.*, 367 I.C.C. 475, 483 (1983), *aff’d sub nom. Aluminum Co. of America v. ICC et al.*, 761 F.2d 746, 750-51 (D.C. Cir. 1985).

¹⁹ The five origin points were Dallas, TX; Ft. Worth, TX; Shreveport, LA; Texarkana, TX; and
(continued...)

TX, was unreasonably high. SWRC purchased the retired cars from other railroads, which delivered them to the point of interchange with MP. MP then moved the cars for SWRC from the various interchange points to the MP yard at Longview, TX, and from there to SWRC's plant at Greggton. At Greggton, SWRC refurbished some cars and dismantled the rest to recover scrap and resalable parts.

In an initial decision, served December 4, 1986 ('86 *Decision*), an ICC administrative law judge (ALJ) concluded that MP had market dominance over this traffic, but that SWRC had not shown that the rate exceeded the maximum reasonable rate level. MP and SWRC each filed an administrative appeal. MP's appeal was directed only to the ALJ's cost findings regarding the r/vc ratio of this traffic, and did not challenge the market dominance finding.²⁰ SWRC's appeal was directed at the ALJ's treatment of the rate reasonableness issue. Thus, the ALJ's market dominance determination was never examined by the ICC or this Board.

On administrative appeal, the ICC affirmed the ALJ's cost findings, concluded that this case was not appropriate for applying the *Coal Rate Guidelines*,²¹ and began to explore other rate reasonableness tests to apply.²² The ICC subsequently decided to apply an r/vc comparison test, and awarded reparations to SWRC based on the average r/vc level of movements of iron and steel scrap, as a statistically adequate sample of retired cars moving on their own wheels could not be found.²³ However, after both MP and SWRC challenged that decision in court,²⁴ the ICC reopened this case.²⁵

The ICC ultimately concluded that an r/vc comparison could not be used as a sole measure

¹⁹(...continued)
Big Sandy, TX.

²⁰ ICC Decision served July 10, 1987 ('87 *Decision*), at 2, 5 n.5. In the '96 *Decision*, at 2, we mistakenly suggested that the ICC's '87 *Decision* had examined and affirmed the ALJ's market dominance finding.

²¹ *Coal Rate Guidelines--Nationwide*, 1 I.C.C.2d 520, 526 (1985), *aff'd sub nom. Consolidated Rail Corp. v. United States*, 812 F.2d 1444 (3d Cir. 1987).

²² ICC decision served July 10, 1987.

²³ ICC decision served December 12, 1988.

²⁴ *Missouri Pac. R.R. v. ICC et al.*, No. 88-1887 (D.C. Cir. dismissed June 13, 1990); *Southwest Railroad Car Parts Co. v. United States et al.*, No. 89-1112 (D.C. Cir. dismissed June 13, 1990).

²⁵ ICC decision served June 1, 1990.

of maximum reasonable rates.²⁶ Instead, it proposed to use the three r/vc benchmarks that we ultimately adopted in *Simplified Guidelines* and sought to apply to this case in the '96 *Decision*.

In the '96 *Decision*, we found that the composite weighted average r/vc ratio produced for the SWRC traffic by the challenged rate over the time period involved was 242%. We noted that this pricing level was consistent with (or unremarkable in relation to) UP's revenue needs, as reflected in UP's RSAM range for that time period.²⁷ It was also consistent with how UP priced comparable (single-car, single-line, short-distance) potentially captive traffic.²⁸ We were unable to include the R/VC_{COMP} benchmark in our analysis,²⁹ because we were persuaded by the parties' previous arguments in court that iron and steel scrap does not constitute comparable traffic and we were unable to identify any other suitable specific commodity for comparison, given the unusual nature of the SWRC traffic. Based on the other two benchmarks, however, we tentatively concluded that the challenged rate was not unreasonably high,

Notwithstanding that initial conclusion, we provided SWRC an opportunity to introduce further evidence or argument, within 60 days, to show that the markup collected on its traffic was too high. '96 *Decision* at 6, 9. On February 26, 1997, SWRC submitted a pleading requesting further consideration, arguing that the demand elasticity of its traffic was not properly taken into account in our prior decision. UP submitted a reply on March 24, 1997, maintaining that we properly applied the *Simplified Guidelines*, but that if we were to reconsider this case we should find that UP lacked market dominance over SWRC's traffic.

²⁶ *Rate Guidelines--Non-Coal Proceedings*, Ex Parte No. 347 (Sub-No. 2) (STB served Dec. 31, 1996) (*Simplified Guidelines*), slip op. at 7,8, *pet. for judicial review pending sub nom. Association of American Railroads v. Surface Transp. Bd. et al.*, No. 97-1020 (D.C. Cir. filed Jan. 10, 1997).

²⁷ The RSAM benchmark is described in detail in *Simplified Guidelines*, slip op. at 19-24. UP's composite RSAM range for the years 1986 through 1988 was 216% to 252%.

²⁸ The $R/VC_{>180}$ benchmark is described in detail in *Simplified Guidelines*, slip op. at 28-30. UP's composite $R/VC_{>180}$ figure for all of its potentially captive traffic in the years 1986 through 1988 was 228%. However, as explained in the '96 *Decision* (at 8), carriers are not expected to price their potentially captive traffic uniformly, but are expected to price differentially. Moreover, intuitively, one would expect single-line, single-car, short-distance traffic to receive a higher markup than traffic moving longer distances in larger volumes using multiple-car and unit-train pricing. Indeed, UP's composite average pricing for the single-car, single-line, short-distance (less than 200-mile) potentially captive traffic that it handled during that same time period was 250%. Thus, UP's markup on the rate challenged by SWRC was below-average for such traffic.

²⁹ The R/VC_{COMP} test is described in detail in *Simplified Guidelines*, slip op. at 24-28.

DISCUSSION

Based on the pleadings filed by both parties in response to the '96 *Decision*, it appears that UP lacked market dominance over the traffic at issue. Because market dominance is a prerequisite to our ability to consider the reasonableness of the challenged rates, it appears that we could not grant SWRC rate relief in this case in any event.

A. SWRC's Submission

SWRC would have us base our rate reasonableness analysis on its rate experience with UP, which SWRC argues provides the best, most direct evidence of the demand elasticity of its traffic. Specifically, SWRC asserts that all other rail cars for reclamation moved under an industrywide flat rate of \$193 per car; that SWRC refused to ship non-UP cars to its Greggton facility at the \$300 per car challenged rate (which explains why UP canceled the rate, leading us mistakenly to assume that SWRC had closed its Greggton facility); and that UP implicitly acknowledged its pricing error 10 years later by introducing a \$210 per car rate for this traffic.

SWRC's argument is unpersuasive; as UP points out, we cannot assess the reasonableness of a rate based only on a dollar-for-dollar rate comparison, without considering the carrier's costs of providing the service. More importantly, however, it demonstrates that the shipper had the ability to maintain its Greggton facility while avoiding the challenged rate (by utilizing its facilities located on the lines of other railroads to receive non-UP cars). In other words, SWRC appears not to have been captive to UP, but instead to have had effective geographic competitive alternatives available to it.

SWRC's alternative argument also suggests that its traffic was not captive to UP. SWRC argues that, to take into account the demand elasticity of its traffic in our rate analysis, we should apply the R/VC_{COMP} test, using a comparison group derived from movements in the Waybill Sample³⁰ data base that come within Standard Transportation Commodity Code (STCC) 37-422 (empty cars).³¹ Moreover, SWRC insists that we should include in the comparison group traffic priced below the 180% r/vc level.

We first note that we could not fashion an appropriate comparison group of retired rail cars from STCC 37-422 movements in the Waybill Sample, because movements classified under the STCC 37-422 grouping are not limited to deliveries of retired cars to buyers. Indeed, most movements under the STCC 37-422 grouping are for other purposes, such as deliveries of new cars

³⁰ The Waybill Sample is a statistical sampling of railroad traffic that is collected and maintained by the Association of American Railroads (AAR), under our oversight, for use by the Board and the public, with appropriate restrictions to protect the confidentiality of individual traffic data.

³¹ STCC 37-422 contains 15 subcategories of movements, 5 of which can be excluded here because they consist of cars not moving on their own wheels.

to their owners, respotting of cars in active service (whether private cars or railroad-owned cars) to their next service point, and movements of active cars to cleaning or repair facilities. We have no practicable means of identifying those movements that involved retired cars.³²

More importantly, we note that most STCC 37-422 traffic was priced at presumptively competitive levels. Less than 3% of the STCC 37-422 traffic had r/vc ratios above 180% during that time period.³³ As noted above, traffic priced below the 180% r/vc level is conclusively presumed not to be captive under 49 U.S.C. 10709(d)(2). Thus, under principles of demand-based differential pricing, this competitively priced traffic cannot serve as a measure for the pricing of captive traffic.³⁴ In continuing to insist that its traffic be compared to competitively-priced traffic, SWRC seems to suggest that its traffic is in fact comparable, i.e., not captive.

B. UP's Submission

UP argues that SWRC's traffic is indeed not captive, based on SWRC's own admissions in court. UP submits excerpts from SWRC's brief, dated May 10, 1990, submitted to the United States Court of Appeals for the District of Columbia Circuit in No. 89-1112. In that brief, at 15-16, SWRC first described a highly competitive market for the transportation of retired rail cars:

[C]ompetition from other railroads is the greatest reason a railroad loses movements of empty railcars. That is because all railroads provide free delivery of their empty railcars to

³² SWRC would have us identify those movements that involve cars that are over 30 years old. However, car age is not included in waybill information. Our only possible means of identifying retired cars would be to compare the car numbers for movements captured in the Waybill Sample under STCC 37-422 against car numbers appearing in subsequent editions of the *Official Railway Equipment Register (Equipment Register)*, a quarterly publication listing active rail cars, so as to exclude those which do not appear in subsequent years. However, because such a comparison is not automated, but must be done manually, it is not feasible for the large number of movements contained in STCC 37-422.

Moreover, the absence of a car number in a later edition of the *Equipment Register* would not necessarily mean that the car had been sold to a reclamation facility. But even if a car had ultimately been sent to such a facility, that would not necessarily mean that the movement captured in the Waybill Sample was made after retirement of the car and constituted movement of the car to a reclamation facility.

³³ We note that, looking only at the potentially captive (i.e. >180% r/vc) portion of STCC 37-422 movements, the average r/vc ratio during the time period covered by the complaint was 255%. Thus, the markup on SWRC's traffic was below-average in comparison to all potentially captive STCC 37-422 movements.

³⁴ *Burlington Northern*, 985 F.2d at 599-600.

consumers F.O.B. any destination on their own system. This puts a competing carrier, one that wants to move those railcars off a competitor's system to a consumer on its own system, at a disadvantage. If it assigns a large portion of its unattributable costs to the rate for the transportation of those railcars, from its competitor's line to the consumer on its line, it will lose the movement. The consumer will be unable to buy the cars, since it must factor that rate into the price it bids for the railcars while its competitor does not. . . . Therefore, the railroad must set a rate which makes it possible for a consumer on its system to buy the off-line cars. Logically, the rate must be higher than the variable cost of providing such transportation, but only slightly higher.

SWRC then described in very specific terms the geographic competitive alternatives available to it (Brief at 16-17):

In the railroad reclamation industry . . . [t]he relative ease of relocating makes the demand for rail transportation too flexible to absorb many unattributable costs. Frequently, it may be possible to process off-line cars on location. If not, it may be worthwhile to lease a spur track somewhere on-line and have the cars delivered there. In some cases, it would be advisable to open another facility permanently. Either way, it requires a relatively small investment . . . , and the overcharging carrier loses the traffic forever.

The MP has ignored this fundamental principle of differential pricing on more than one occasion, and each time [SWRC] has demonstrated its demand elasticity by relocating its facilities in order to avoid unreasonable transportation costs. Today, [SWRC] gets free delivery of Burlington Northern cars at its Jewett[, Texas,] facility and free delivery of Santa Fe cars at its Venus[, Texas,] facility.

Finally, SWRC described its ability to overcome certain equipment and technological limitations that it had argued to the ALJ kept its traffic captive³⁵ (Brief at 17):

[I]nstead of pricing transportation at levels which encouraged the use of existing plant and technology, MP set their rates at levels which encouraged the construction of a railcar incinerator at the Jewett facility. Once again, the MP's rates resulted in lost traffic. Today . . . [SWRC's] Venus facility is not equipped with a railcar incinerator. However, one is under construction. Unless the rates are made reasonable prior to its completion, the MP will lose that traffic forever.

C. Preliminary Conclusion

We conclude that UP has made a prima facie case of geographic competition, based on SWRC's own admissions. Moreover, SWRC's submission here indicates the existence of actual or potential geographic competition. Because SWRC has not responded to UP's renewed market

³⁵ See '86 *Decision* at 6-7.

dominance argument, however, we will afford SWRC the opportunity to do so.

This action will not significantly affect either the quality of the human environment or the conservation of energy resources.

It is ordered:

(1) SWRC is directed to show cause, by April 6, 1998, why this proceeding should not be dismissed for lack of market dominance.

(2) UP may submit a reply to the SWRC response by May 6, 1998.

By the Board, Chairman Morgan and Vice Chairman Owen.

Vernon A. Williams
Secretary